DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS: 01-0066SLOF
Indiana Corporate Income Tax
For the Years 1993, 1994, and 1995

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ISSUE

I. **Reimbursement of Intracompany Expenses** – Gross Income Tax.

Authority: IC 6-2.1-1-2(a); IC 6-2.1-1-11; IC 6-2.1-2-2; IC 6-2.1-2-2(a)(2); 45 IAC 1-1-9; 45 IAC 1-1-10; 45 IAC 1.1-1-5.

Taxpayer argues that the audit review improperly included, as amounts subject to gross income tax, intracompany transfers of expenses.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of developing, manufacturing, and selling items related to automobiles, defense, electronics, and "fluid technologies." Taxpayer has manufacturing facilities located in Indiana. The Department of Revenue (Department) conducted an audit review of taxpayer's business records and tax returns. The Department's review resulted in the assessment of additional corporate income tax for 1993, 1994, and 1995. Taxpayer disagreed with a number of the assessments and submitted a protest to that effect. An administrative hearing was conducted, and a Letter of Findings was issued. Taxpayer challenged the conclusions contained within the Letter of Findings and requested a rehearing. The Department agreed with the taxpayer's request, a rehearing was conducted, and this Supplemental Letter of Findings results.

DISCUSSION

I. **Reimbursement of Intracompany Expenses** – Gross Income Tax.

Taxpayer argues that the audit review erred when it determined that certain transfers of expenses and reimbursements were subject to gross income tax. Taxpayer maintains that these reimbursements were merely "phantom payments," that no money was received from outside sources, and that the reimbursements were simply an intracompany reallocation of expenses initially incurred by one particular operating group and allocated among its various divisions and subdivisions.

Taxpayer describes these particular transactions as follows: In operating its business, taxpayer incurs a particular expense. For example, taxpayer incurs $100 in legal costs. Taxpayer then determines which of its three major divisions is responsible for the $100 expense. Taxpayer may decide that the $100 expense is attributable to major division one, two, or three. After making the decision, taxpayer charges that particular major division for the $100. Shortly thereafter, that major division will make a $100 book-entry reimbursement to taxpayer. As taxpayer describes this process, no money ever changes hands. The charges and reimbursements do not represent money received from outside parties. According to taxpayer, the system is simply an accounting procedure by which each of the major divisions is held responsible for the cost of performing some service. In the example cited, one of the major divisions was the particular entity which was "charged" with the $100 legal expense.

Similarly, the charge and reimbursement system functions at the major division / subdivision level. One of the major divisions incurs a certain expense. For example, major division one incurs a $200 advertising expense. Major division one then determines that this particular expense is attributable to two of the sub-divisions operating within that major division; it determines that subdivision "A" is responsible for $50 of the advertising expense, and subdivision "B" is responsible for the remaining $150. Major division one "charges" these two subdivisions the apportioned costs, the two subdivisions make a book-entry "reimbursement" for the cost, and – according to taxpayer's description – the original $200 expense is properly apportioned between the two subdivisions actually responsible for the advertising cost.

It is taxpayer's contention that all of these reimbursements are merely "phantom payments" and do not represent the receipt of actual money. Because, according to taxpayer, all of these phantom book entries are merely accounting fictions, the audit's decision to find that the "reimbursements" are subject to gross income tax is erroneous.

Under the provisions of IC 6-2.1-2-2, the state's gross income tax is imposed on the receipt of "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a)(2).

"Gross income" is defined at IC 6-2.1-1-2(a) which states, in part, that "Except as expressly provided in this article, 'gross income" means all the gross receipts a taxpayer receives: (1) from trades, businesses, or commerce . . . and (10) from any other source not specifically defined in this subsection." "Receives" is defined at IC 6-2.1-1-11 which states that "'Receives', as applied to a taxpayer, means (1) the actual coming into possession of, or the crediting to, the taxpayer, of gross income; or (2) the payment of the taxpayer's expenses, debts, or other obligations by a third party for the taxpayer's direct benefit." Id.

The Department's regulation defines those instances in which a taxpayer receives income subject to the gross income tax. 45 IAC 1-1-9 (1979) states that, "'[R]eceived' means either the actual coming into possession of gross income by the taxpayer or the crediting

to him of gross income." *See* 45 IAC 1.1-1-5 (1999). The regulation further states that, "It is not necessary for gross income to actually come into the taxpayer's possession to be his gross income. Whenever gross income is 'received' in any manner other than by actual possession, gross income is considered to be 'constructively received.'" Id. The regulation defines " 'Constructive receipts' [as] those items of gross income which are not actually received by the taxpayer but which are credited to him, available for his withdrawal, paid to another for his benefit, or represent income to which he is entitled." 45 IAC 1-1-10 (1978); *See* 45 IAC 1.1-1-5 (1999).

If taxpayer were simply moving money from one corporate pocket into another, taxpayer's argument would merit consideration because such strictly intra-company transactions would be entirely transparent for gross income tax purposes. However, on taxpayer's corresponding federal tax returns these purportedly intra-company reimbursements were reflected on line 26 of the federal form for "Other Deductions." These identical reimbursements were shown on the federal form as a credit labeled "Rent, Services, and Other Overhead Items" on the schedule of "Other Deductions" attached to the original federal return supporting the line 26 "Other Deductions." With all due respect to taxpayer's internal accounting procedures, taxpayer's argument appears to be at odds with how these amounts were treated for federal tax purposes; taxpayer's treatment of these particular amounts on its federal return is inconsistent with its contention that the transfer of these amounts has no state gross income tax effect. If these amounts were in fact merely intra-company reallocations of expenses, the expense reallocations would not be reported on the corresponding federal tax return as a credit to "Other Deductions."

FINDING

Taxpayer's protest is respectfully denied.

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